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March 2, 1981

MEMO TO: All ASAE Members

FROM: Jim Low and John Vickerman

GOVERNMENT RELATIONS UPDATE

-3-

FOREIGN CONVENTIONS -- The Treasury Department expects to propose regulations governing the new foreign convention law sometime this year. We regard this as a welcome development, since the new law, while a great improvement over the old "602", has some grey areas which can only be resolved by regulation.

We will keep you posted on developments in this area, and ASAE will have comments on the regulations when they are published.

TREASURY ISSUES (c)(9) REGS -- Despite almost uniform opposition from every interested group, the Treasury Department has adopted regulations which will adversely affect nearly every association (c)(9) insurance trust.

The regulations were delivered to the Federal Register on December 30 and became effective January 1, giving associations no opportunity to bring their trusts into compliance before the effective date. This rush to publish looks somewhat suspicious when you consider that Treasury has waited 52 years to issue regs.

The worst provision in the new regs is the requirement that a (c)(9) trust must be composed of participants sharing a common employment and geographic bond. Treasury makes it clear that a national field of membership will not satisfy the requirement, so (c)(9) trusts maintained by national associations for their members are now taxable. In addition, the regs tax any trust which discriminates in favor of one class of employees, such as executives.

The new regs also provide that any (c)(9) trust not subject to Title 1 of ERISA must be controlled by the participants. In other words, a trust operated by an association for its employees, or employees of members, would have to be "controlled" by individuals who in most cases have no responsibility for financing or administering the trust.

These are bad regulations, and should be withdrawn. If your association has a (c)(9) trust, you should take the following actions: write to The Hon. John E. Chapoton, Assistant Secretary for Tax Policy, Department of the Treasury, Washington, D.C. 20220, and to the Hon. Roscoe Egger, Commissioner, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224. Tell them that the 501(c)(9) regulations, which were unanimously opposed by interested organizations, were issued at the last moment by the Carter Administration. Give examples, if you have them, of how the regs will affect your association, and ask that the regs be withdrawn, so the new Administration will have an opportunity to study them and come up with new and more workable proposals.

Send copies of your letters to John Vickerman at ASAE.

IRS FINAL REGULATIONS ON VOLUNTARY EMPLOYEES' BENEFICIARY ASSOCIATIONS
46 FR 1719, Jan. 7, 1981

26 CFR Part 1

(T.D. 7750)

Income Tax; Taxable Years Beginning After December 31, 1954; Voluntary Employees' Beneficiary Associations

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to voluntary employees' beneficiary associations. The regulations provide guidance needed to determine whether an organization is a voluntary employees' beneficiary association under the Internal Revenue Code of 1954, as amended, and therefore exempt from federal income tax.

DATE: The regulations are, with certain exceptions effective for taxable years beginning after December 31, 1954.

FOR FURTHER INFORMATION CONTACT: Kimley R. Johnson of the Employee Plans and Exempt Organizations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-6212, not a toll-free call).

SUPPLEMENTARY INFORMATION:**Background**

On July 17, 1980, the Federal Register published proposed amendments to the Income Tax Regulations (26 CFR Part 1) under section 501(c)(9) of the Internal Revenue Code of 1954 (45 FR 47871), as amended by section 121 of the Tax Reform Act of 1969 (83 Stat. 541), concerning voluntary employees' beneficiary associations. Approximately 240 comments were received; a public hearing was held on October 14, 1980. After consideration of all comments regarding the proposed regulations those regulations are adopted as revised by this Treasury decision.

Control by Employees

Almost all comments requested deletion or modification of the provision of the proposed regulations which required that an association be controlled by its membership, or by independent trustee(s), or by trustees or other fiduciaries at least some of whom are designated by, or on behalf of, the membership. In response to these comments, many of which pointed out that section 501(c)(9) organizations are generally subject to the provisions of Title I of the Employee Retirement

Income Security Act of 1974 (ERISA), the proposed regulations have been amended to provide that employee welfare benefit plans within the scope of section 3(1) of ERISA and subject to Parts 1 and 4 of Title I of ERISA will be considered to be controlled by independent trustees. The reporting and disclosure requirements of Part 1 of Title I of ERISA are so designed as to ensure that employees are informed of the status of the association's benefit plan. The fiduciary standards set out in Part 4 of Title I of ERISA protect the interests of participants by establishing standards of conduct for plan fiduciaries.

The proposed regulations also are revised to indicate more clearly that where the designation of the trustee(s) of a collectively bargained plan is the result of the collective bargaining process, the plan is deemed to meet the control requirement of the regulations. Where a plan is negotiated through collective bargaining, but the employees' bargaining agent has not bargained for the right to participate in selection of the trustee and the trustee therefore is designated by the employer, the control requirement also will be considered satisfied. In addition, a financial intermediary such as a bank, acting in a fiduciary capacity, generally will be considered to be an independent trustee.

Disproportionate Benefits

A number of comments suggested that the rule against discrimination in the provision of benefits has no basis in the statutory language of or legislative history to section 501(c)(9) and requested deletion or modification of that rule. However, substantially the same provision appeared in the 1969 version of the proposed regulations, published in the Federal Register on January 23, 1969. That provision, when proposed in 1969, attracted little adverse comment from the public. In addition, the Tax Reform Act of 1969, enacted nearly one year after the 1969 notice was published, amended section 501(c)(9) and related provisions in several respects. Despite these revisions to section 501(c)(9), Congress, in the Tax Reform Act of 1969, neither changed nor commented on this aspect of the proposed regulations.

The antidiscrimination provision is retained but clarified. First, the regulations recognize that, in determining whether a plan

discriminates in eligibility for membership (or for a particular benefit), the failure to cover employees represented by a collective bargaining agent who in the collective bargaining process has eschewed membership (or a particular benefit) need not be taken into account. In addition, the regulations indicate that while an employer-funded organization may not restrict membership or eligibility for benefits to officers, shareholders, or highly compensated employees of the employer, section 501(c)(9) organizations need not comply with antidiscrimination rules as stringent as those that apply to qualified pension trusts described in section 401 of the Code. The final regulations provide, however, that section 501(c)(9) organizations that are employer-funded may not provide disproportionate benefits to officers, shareholders, or highly compensated employees of the funding employer. This rule is the same as that contained in the 1969 proposed regulations. On the other hand, these final regulations indicate a variety of circumstances under which benefits will not be considered disproportionate. In particular, they indicate that for certain kinds of benefits, such as life insurance or disability benefits, the provision of benefits in amounts that are a uniform percentage of compensation of covered employees will not be considered disproportionate.

In response to several comments, the final regulations have been revised to indicate that, where a plan does not discriminate in eligibility for benefits, the fortuitous payment during any year of disproportionate benefits to officers, shareholders, or highly compensated employees, because, for example, such individuals as a group suffered more adverse experience during the year, will not be considered disproportionate.

Membership

Several comments requested deletion of the provision that restricts membership in voluntary employees' beneficiary associations in the multiple employer context (so-called "multi-employer trusts") to those engaged in the same line of business in the same geographic locale. This provision is retained. First, section 501(c)(9) provides for the exemption of associations of employees who enjoy some employment related bond. Allowing section 501(c)(9) to be used as a tax-exempt vehicle for offering insurance products to unrelated individuals scattered throughout the

Approved For Release 2003/11/06 : CIA-RDP84-00688R000200170002-5

country would undermine those provisions of the Internal Revenue Code that prescribe the income tax treatment of insurance companies. Second, it is the position of the Internal Revenue Service that where an organization such as a national trade association or business league exempt from taxation under section 501(c)(6) operates a group insurance program for its members, the organization is engaged in an unrelated trade or business. See Rev. Rul. 66-151, 1966-1 C.B. 152; Rev. Rul. 73-386, 1973-2 C.B. 191; Rev. Rul. 78-52, 1978-1 C.B. 166. To allow trade associations to provide insurance benefits through a trust exempt under section 501(c)(9) would simply facilitate circumvention of the unrelated trade or business income tax otherwise applicable to such organizations.

A number of comments suggested that the regulations as proposed would prohibit the qualification of plans that cover only retired employees. The regulations as adopted are clarified to indicate that retired members are considered to be employees if the retired member was at one time an active employee.

Life, Sick, Accident, or Other Benefits

The regulations are clarified to provide that the definition of a dependent for purposes of the provision of benefits under section 501(c)(9) is not necessarily identical to the definition of a dependent under section 152(a). Qualified benefits may be provided to a minor or student child of a member or member's spouse, or to any other minor child residing with the member, even if the support test of section 152(a) is not met.

Because of uncertainty on the point, it is specifically noted that the regulations as proposed and as adopted by this Treasury decision permit a section 501(c)(9) organization that receives employer funding to use insurance policies involving cash values only where the policies are part of a plan of so-called "group-permanent" life insurance subject to section 79 and the regulations thereunder. In addition, the revised regulations indicate that collectively bargained trusts may provide, by reason of section 302(c)(5) of the Labor Management Relations Act of 1947, legal service benefits and scholarships to dependents. Such trusts may not, although permitted to do so by section 302(c)(5), provide any benefit that is similar to a pension or other retirement income benefit except as specifically permitted by the final regulations.

Several comments requested that a provision be added to state that death

benefits paid by a self-funded plan are eligible for exclusion from the gross income of the beneficiary under section 101(a) of the Code. This issue is not addressed in these regulations, which are intended to clarify the provisions of section 501(c)(9) and not to resolve income tax or other issues that may arise under other sections of the Code.

Finally, several comments suggested that the regulations should be revised to allow the proceeds of life insurance policies provided through a section 501(c)(9) organization to be settled in the form of an annuity to the beneficiary, even where the beneficiary does not have the option to take the policy proceeds in a lump sum. The regulations are revised to permit settlement of a life insurance policy in the form of an annuity where the treatment of the annuity is the same as if the annuity had been taken in lieu of a lump sum, that is, where the interest element in the periodic annuity payment is includable in the recipient's gross income.

Effective Dates

Several comments requested a delay in the effective date of final regulations, particularly because of difficulties in meeting the "employee control" and "discrimination" tests discussed above. The "employee control" test, however, has been modified in the fashion requested by most commenters. The discrimination rules have been revised to reflect the concept of "disproportionate benefits" contained in the 1969 proposed regulations and the concept of "disproportionate" itself has been clarified in a way requested by many commenters. Consequently, the effective date of the final regulations has not been changed.

Drafting Information

The principal author of this regulation is Kimley R. Johnson of the Employee Plans and Exempt Organizations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR Part 1 is amended by adding the following new sections immediately after § 1.501(c)(8)-1:

§ 1.501(c)(9)-1 Voluntary employees' beneficiary associations, in general.

To be described in section 501(c)(9) an organization must meet all of the following requirements:

(a) The organization is an employees' association.

(b) Membership in the association is voluntary.

(c) The organization provides for the payment of life, sick, accident, or other benefits to its members or their dependents or designated beneficiaries, and substantially all of its operations are in furtherance of providing such benefits, and

(d) No part of the net earnings of the organization inures, other than by payment of the benefits referred to in paragraph (c) of this section, to the benefit of any private shareholder or individual.

§ 1.501(c)(9)-2 Membership in a voluntary employees' beneficiary association; employees; voluntary association of employees.

(a) *Membership*—(1) *In general.* The membership of an organization described in section 501(c)(9) must consist of individuals who become entitled to participate by reason of their being employees and whose eligibility for membership is defined by reference to objective standards that constitute an employment-related common bond among such individuals. Typically, those eligible for membership in an organization described in section 501(c)(9) are defined by reference to a common employer (or affiliated employers), to coverage under one or more collective bargaining agreements (with respect to benefits provided by reason of such agreements), to membership in a labor union, to membership in one or more locals of a national or international labor union. For example, membership in an association might be open to all employees of a particular employer, to employees in specified job classifications working for certain employers at specified locations who are entitled to benefits under one or more collective bargaining agreements. In addition, membership might be limited to employees in the same line of business in the same geographic locale who share an employment-related bond for purposes of an organization in which their employees are considered to share an employment-related common bond. Employees of a labor union are considered to share an employment-related common bond with the union, and employees of an association will be considered to share an employment-related common bond if the association will be considered to share an employment-related common bond with its members.

with members of the association. Whether a group of individuals is defined by reference to a permissible standard or standards is a question to be determined with regard to all the facts and circumstances, taking into account the guidelines set forth in this paragraph. Exemption will not be denied merely because the membership of an association includes some individuals who are not employees (within the meaning of paragraph (b) of this section), provided that such individuals share an employment-related bond with the employee-members. Such individuals may include, for example, the proprietor of a business whose employees are members of the association. For purposes of the preceding two sentences, an association will be considered to be composed of employees if 90 percent of the total membership of the association on one day of each quarter of the association's taxable year consists of employees (within the meaning of paragraph (b) of this section).

(2) *Restrictions*—(i) *In general.* Eligibility for membership may be restricted by geographic proximity, or by objective conditions or limitations reasonably related to employment, such as a limitation to a reasonable classification of workers, a limitation based on a reasonable minimum period of service, a limitation based on maximum compensation, or a requirement that a member be employed on a full-time basis. Similarly, eligibility for benefits may be restricted by objective conditions relating to the type or amount of benefits offered. Any objective criteria used to restrict eligibility for membership or benefits may not, however, be selected or administered in a manner that limits membership or benefits to officers, shareholders, or highly compensated employees of an employer contributing to or otherwise funding the employees' association. Similarly, eligibility for benefits may not be subject to conditions or limitations that have the effect of entitling officers, shareholders, or highly compensated employees of an employer contributing to or otherwise funding the employees' association to benefits that are disproportionate in relation to benefits to which other members of the association are entitled. See § 1.501(c)(9)-4(b). Whether the selection or administration of objective conditions has the effect of providing disproportionate benefits to officers, shareholders, or highly compensated employees generally is to be determined on the basis of all the facts and circumstances.

(ii) *Generally permissible restrictions or conditions.* In general the following restrictions will not be considered to be inconsistent with § 1.501(c)(9)-2(a)(2)(i) or § 1.501(c)(9)-4(b):

(A) In the case of an employer-funded organization, a provision that excludes or has the effect of excluding from membership in the organization or participation in a particular benefit plan employees who are members of another organization or covered by a different plan, funded or contributed to by the employer, to the extent that such other organization or plan offers similar benefits on comparable terms to the excluded employees.

(B) In the case of an employer-funded organization, a provision that excludes from membership, or limits the type or amount of benefits provided to, individuals who are included in a unit of employees covered by an agreement which the Secretary of Labor finds to be a collective bargaining agreement between employee representatives and one or more employers, if there is evidence that the benefit or benefits provided by the organization were the subject of good faith bargaining between such employee representatives and such employer or employers.

(C) Restrictions or conditions on eligibility for membership or benefits that are determined through collective bargaining, by trustees designated pursuant to a collective bargaining agreement, or by the collective bargaining agents of the members of an association or trustees named by such agent or agents.

(D) The allowance of benefits only on condition that a member or recipient contribute to the cost of such benefits, or the allowance of different benefits based solely on differences in contributions, provided that those making equal contributions are entitled to comparable benefits.

(E) A requirement that a member (or a member's dependents) meet a reasonable health standard related to eligibility for a particular benefit.

(F) The provision of life benefits in amounts that are a uniform percentage of the compensation received by the individual whose life is covered.

(G) The provision of benefits in the nature of wage replacement in the event of disability in amounts that are a uniform percentage of the compensation of the covered individuals (either before or after taking into account any disability benefits provided through social security or any similar plan providing for wage replacement in the event of disability).

(3) *Examples.* The provisions of this section may be illustrated by the following examples:

Example (1). Pursuant to a collective bargaining agreement entered into by X Corporation and W, a labor union which represents all of X Corporation's hourly-paid employees, the X Corporation Union Benefit Plan is established to provide life insurance benefits to employees of X represented by W. The Plan is funded by contributions from X, and is jointly administered by X and W. In order to provide its non-unionized employees with comparable life insurance benefits, X also establishes and funds the X Corporation Life Insurance Trust. The Trust will not be ineligible for exemption as an organization described in section 501(c)(9) solely because membership is restricted to those employees of X who are not members of W.

Example (2). The facts are the same as in Example (1) except that the life insurance benefit provided to the non-unionized employees of X differs from the life insurance benefit provided to the unionized employees of X pursuant to the collective bargaining agreement. The trust will not be ineligible for exemption as an organization described in section 501(c)(9) solely because the life insurance benefit provided to X's nonunionized employees is not same as the life insurance benefit provided to X's unionized employees.

Example (3). S corporation established a plan to provide health benefits to all its employees. In accordance with the provisions of the plan each employee may secure insurance coverage by making an election under which the employee agrees to contribute periodically to the plan an amount which is determined solely by whether the employee elects a high option coverage or a low option coverage and on whether the employee is unmarried or has a family. As an alternative, the employee may elect high or low options, self only or self and family, coverage through a local prepaid group medical plan. The contributions required of those electing the prepaid group medical plan also vary with the type of coverage selected, and differ from those required of employees electing insurance. The difference between the amount contributed by employees electing the various coverages and the actual cost of purchasing the coverage is made up through contributions by S to the plan, and under the plan, S provides approximately the same proportion of the cost for each coverage. To fund the plan, S established an arrangement in the nature of a trust under applicable local law and contributes all employee contributions, and all amounts which by the terms of the plan it is required to contribute, to the trust. The terms of the plan do not provide for disproportionate benefits to the employees of S and will not be considered inconsistent with § 1.501(c)(9)-2(a)(2)(i).

Example (4). The facts are the same as in Example (3) except that, for those employees or former employees covered by Medicare, the plan provides a distinct coverage which supplements Medicare benefits. Eligibility for Medicare is an objective condition relating to a type of benefit offered, and the provision of

separate coverage for those eligible for Medicare will not be considered inconsistent with § 1.501(c)(9)-2(a)(2)(i).

(b) *Meaning of "employee".* Whether an individual is an "employee" is determined by reference to the legal and bona fide relationship of employer and employee. The term "employee" includes the following:

(1) An individual who is considered an employee:

(i) For employment tax purposes under Subtitle C of the Internal Revenue Code and the regulations thereunder, or

(ii) For purposes of a collective bargaining agreement, whether or not the individual could qualify as an employee under applicable common law rules. This would include any person who is considered an employee for purposes of the Labor Management Relations Act of 1947, 61 Stat. 136, as amended, 29 U.S.C. 141 (1979).

(2) An individual who became entitled to membership in the association by reason of being or having been an employee. Thus, an individual who would otherwise qualify under this paragraph will continue to qualify as an employee even though such individual is on leave of absence, works temporarily for another employer or as an independent contractor, or has been terminated by reason of retirement, disability or layoff. For example, an individual who in the normal course of employment is employed intermittently by more than one employer in an industry characterized by short-term employment by several different employers will not, by reason of temporary unemployment, cease to be an employee within the meaning of this paragraph.

(3) The surviving spouse and dependents of an employee (if, for purposes of the 90-percent test of § 1.501(c)(9)-2(a)(1) they are considered to be members of the association).

(c) Description of voluntary association of employees.—(1)

Association. To be described in section 501(c)(9) and this section there must be an entity, such as a corporation or trust established under applicable local law, having an existence independent of the member-employees or their employer.

(2) *Voluntary.* Generally, membership in an association is voluntary if an affirmative act is required on the part of an employee to become a member rather than the designation as a member due to employee status. However, an association shall be considered voluntary although membership is required of all employees, provided that the employees do not incur a detriment

(for example, in the form of deductions from pay) as the result of membership in the association. An employer is not deemed to have imposed involuntary membership on the employee if membership is required as the result of a collective bargaining agreement or as an incident of membership in a labor organization.

(3) *Of employees.* To be described in this section, an organization must be controlled—

(i) By its membership,
(ii) By independent trustee(s) (such as a bank), or

(iii) By trustees or other fiduciaries at least some of whom are designated by, or on behalf of, the membership. Whether control by or on behalf of the membership exists is a question to be determined with regard to all of the facts and circumstances, but generally such control will be deemed to be present when the membership (either directly or through its representative) elects, appoints or otherwise designates a person or persons to serve as chief operating officer(s), administrator(s), or trustee(s) of the organization. For purposes of this paragraph an organization will be considered to be controlled by independent trustees if it is an "employee welfare benefit plan", as defined in section 3(1) of the Employee Retirement Income Security Act of 1974 (ERISA), and, as such, is subject to the requirements of Parts 1 and 4 of Subtitle B, Title I of ERISA. Similarly, a plan will be considered to be controlled by its membership if it is controlled by one or more trustees designated pursuant to a collective bargaining agreement (whether or not the bargaining agent of the represented employees bargained for and obtained the right to participate in selecting the trustees).

(4) *Examples.* The provisions of this section may be illustrated by the following examples:

Example (1). X, a labor union, represents all the hourly-paid employees of Y Corporation. A health insurance benefit plan was established by X and Y as the result of a collective bargaining agreement entered into by them. The plan established the terms and conditions of membership in, and the benefits to be provided by, the plan. In accordance with the terms of the agreement, Y Corporation is obligated to establish a trust fund and make contributions thereto at specified rates. The trustees, some of whom are designated by X and some by Y, are authorized to hold and invest the assets of the trust and to make payments on instructions issued by Y Corporation in accordance with the conditions contained in the plan. The interdependent benefit plan agreement and trust indenture together create a voluntary employees' beneficiary

association over which the employees possess the requisite control through the trustees designated by their representative, X.

Example (2). Z Corporation unilaterally established an educational benefit plan for its employees. The purpose of the plan is to provide payments for job-related educational or training courses, such as apprenticeship training programs, for Z Corporation employees, according to objective criteria set forth in the plan. Z establishes a separate bank account which it uses to fund payments to the plan. Contributions to the account are to be made at the discretion of and solely by Z Corporation, which also administers the plan and retains control over the assets in the fund. Z Corporation's educational benefit plan and the related account do not constitute an association having an existence independent of Z Corporation and therefore do not constitute a voluntary employees' beneficiary association.

Example (3). A, an individual, is the incorporator and chief operating officer of Lawyers' Beneficiary Association (LBA). LBA is engaged in the business of providing medical benefits to members of the Association and their families. Membership is open only to practicing lawyers located in a particular metropolitan area who are neither self-employed nor partners in a law firm. Membership in LBA is solicited by insurance agents under the control of X Corporation (owned by A) which, by contract with LBA, is the exclusive sales agent. Medical benefits are paid from a trust account containing periodic "contributions" paid by the members, together with proceeds from the investment of those contributions. Contribution and benefit levels are set by LBA. The "members" of LBA do not hold meetings, have no right to elect officers or directors of the Association, and no right to replace trustees. Collectively, the subscribers for medical benefits from LBA cannot be said to control the association and membership is neither more than nor different from the purchase of an insurance policy from a stock insurance company. LBA is not a voluntary employees' beneficiary association.

Example (4). U corporation unilaterally established a plan to provide benefits to its employees. In accordance with the provisions of the plan, each employee may secure insurance or benefit coverage by making an election under which the employee agrees to contribute to the plan an amount which is determined solely by whether the employee elects a high option coverage or a low option coverage and on whether the employee elects self only or self and family coverage. The difference between the amount contributed by employees electing the various coverages and the actual cost of the coverage is made up through contributions by U to the plan. To fund the plan, U established an arrangement in the nature of a trust under applicable local law and contributed all employee contributions, and all amounts which by the term of the plan it was required to provide to the plan, to the trust. The trust constitutes an "employee welfare benefit plan" within the meaning of, and subject to relevant requirements of, ERISA. It will be considered to meet the requirements of § 1.501(c)(9)-2(c)(3).

TEXT

§ 1.501(c)(9)-3 **Voluntary employees' beneficiary associations; life, sick, accident, or other benefits.**

(a) *In general.* The life, sick, accident, or other benefits provided by a voluntary employees' beneficiary association must be payable to its members, their dependents, or their designated beneficiaries. For purposes of section 501(c)(9), "dependent" means the member's spouse; any child of the member or the member's spouse who is a minor or a student (within the meaning of section 151(e)(4)); any other minor child residing with the member; and any other individual who an association, relying on information furnished to it by a member, in good faith believes is a person described in section 152(a). Life, sick, accident, or other benefits may take the form of cash or noncash benefits. A voluntary employees' beneficiary association is not operated for the purpose of providing life, sick, accident, or other benefits unless substantially all of its operations are in furtherance of the provision of such benefits. Further, an organization is not described in this section if it systematically and knowingly provides benefits (of more than a *de minimis* amount) that are not permitted by paragraphs (b), (c), (d), or (e) of this section.

(b) *Life benefits.* The term "life benefits" means a benefit (including a burial benefit or a wreath) payable by reason of the death of a member or dependent. A "life benefit" may be provided directly or through insurance. It generally must consist of current protection, but also may include a right to convert to individual coverage on termination of eligibility for coverage through the association, or a permanent benefit as defined in, and subject to the conditions in, the regulations under section 79. A "life benefit" also includes the benefit provided under any life insurance contract purchased directly from an employee-funded association by a member or provided by such an association to a member. The term "life benefit" does not include a pension, annuity or similar benefit, except that a benefit payable by reason of the death of an insured may be settled in the form of an annuity to the beneficiary in lieu of a lump-sum death benefit (whether or not the contract provides for settlement in a lump sum).

(c) *Sick and accident benefits.* The term "sick and accident benefits" means amounts furnished to or on behalf of a member or a member's dependents in the event of illness or personal injury to a member or dependent. Such benefits may be provided through reimbursement to a member or a member's dependents

for amounts expended because of illness or personal injury, or through the payment of premiums to a medical benefit or health insurance program. Similarly, a sick and accident benefit includes an amount paid to a member in lieu of income during a period in which the member is unable to work due to sickness or injury. Sick benefits also include benefits designed to safeguard or improve the health of members and their dependents. Sick and accident benefits may be provided directly by an association to or on behalf of members and their dependents, or may be provided indirectly by an association through the payment of premiums or fees to an insurance company, medical clinic, or other program under which members and their dependents are entitled to medical services or to other sick and accident benefits. Sick and accident benefits may also be furnished in noncash form, such as, for example, benefits in the nature of clinical care services by visiting nurses, and transportation furnished for medical care.

(d) *Other benefits.* The term "other benefits" includes only benefits that are similar to life, sick, or accident benefits. A benefit is similar to a life, sick, or accident benefit if—

(1) It is intended to safeguard or improve the health of a member or a member's dependents, or

(2) It protects against a contingency that interrupts or impairs a member's earning power.

(e) *Examples of "other benefits."* Paying vacation benefits, providing vacation facilities, reimbursing vacation expenses, and subsidizing recreational activities such as athletic leagues are considered "other benefits". The provision of child-care facilities for preschool and school-age dependents are also considered "other benefits". The provision of job readjustment allowances, income maintenance payments in the event of economic dislocation, temporary living expense loans and grants at times of disaster (such as fire or flood), supplemental unemployment compensation benefits (as defined in section 501(c)(17)(D)(i) of the Code), severance benefits (under a severance pay plan within the meaning of 29 CFR § 2510.3-2(b)) and education or training benefits or courses (such as apprentice training programs) for members, are considered "other benefits" because they protect against a contingency that interrupts earning power. Personal legal service benefits which consist of payments or credits to one or more organizations or trusts described in section 501(c)(20) are considered "other benefits". Except to

the extent otherwise provided in these regulations, as amended from time to time, "other benefits" also include any benefit provided in the manner permitted by paragraphs (5) *et seq.* of section 302(c) of the Labor Management Relations Act of 1947, 61 Stat. 136, as amended, 29 U.S.C. 186(c) (1979).

(f) *Examples of nonqualifying benefits.* Benefits that are not described in paragraphs (d) or (e) of this section are not "other benefits". Thus, "other benefits" do not include the payment of commuting expenses, such as bridge tolls or train fares, the provision of accident or homeowner's insurance benefits for damage to property, the provision of malpractice insurance, or the provision of loans to members except in times of distress (as permitted by § 1.501(c)(9)-3(e)). "Other benefits" also do not include the provision of savings facilities for members. The term "other benefits" does not include any benefit that is similar to a pension or annuity payable at the time of mandatory or voluntary retirement, or a benefit that is similar to the benefit provided under a stock bonus or profit-sharing plan. For purposes of section 501(c)(9) and these regulations, a benefit will be considered similar to that provided under a pension, annuity, stock bonus or profit-sharing plan if it provides for deferred compensation that becomes payable by reason of the passage of time, rather than as the result of an unanticipated event. Thus, for example, supplemental unemployment benefits, which generally become payable by reason of unanticipated layoff, are not, for purposes of these regulations, considered similar to the benefit provided under a pension, annuity, stock bonus or profit-sharing plan.

(g) *Examples.* The provisions of this section may be further illustrated by the following examples:

Example (1). V was organized in connection with a vacation plan created pursuant to a collective bargaining agreement between M, a labor union, which represents certain hourly paid employees of T corporation, and T. The agreement calls for the payment by T to V of a specified sum per hour worked by T employees who are covered by the collective bargaining agreement. T includes the amounts in the covered employees' wages and withholds income and FICA taxes. The amounts are paid by T to V to provide vacation benefits provided under the collective bargaining agreement. Generally, each covered employee receives a check in payment of his or her vacation benefit during the year following the year in which contributions were made by T to V. The amount of the vacation benefit is determined by reference to the contributions during the prior year to V

by T on behalf of each employee, and is distributed in cash to each such employee. If the earnings on investments by V during the year preceding distribution are sufficient after deducting the expenses of administering the plan, each recipient of a vacation benefit is paid an amount, in addition to the contributions on his or her behalf, equal to his/her ratable share of the net earnings of V during such year. The plan provides a vacation benefit that constitutes an eligible "other benefit" described in section 501(c)(9) and § 1.501(c)(9)-3(e).

Example (2). The facts are the same as in Example 1, except that each covered employee of T is entitled, at his or her discretion, to contribute up to an additional \$1,000 each year to V, which agrees in respect of such sum to pay interest at a stated rate from the time of contribution until the time at which the contributing employee's vacation benefit is distributed. In addition, each employee may elect to leave all or a portion of his/her distributable benefit on deposit past the time of distribution, in which case interest will continue to accrue. Because the plan more closely resembles a savings arrangement than a vacation plan, the benefit payable to the covered employees of T is not a "vacation benefit" and is not an eligible "other benefit" described in section 501(c)(9) and § 1.501(c)(9)-3 (d) or (e).

§ 1.501(c)(9)-4 Voluntary employees' beneficiary associations; inurement.

(a) *General rule.* No part of the net earnings of an employees' association may inure to the benefit of any private shareholder or individual other than through the payment of benefits permitted by § 1.501(c)(9)-3. The disposition of property to, or the performance of services for, a person for less than the greater of fair market value or cost (including indirect costs) to the association, other than as a life, sick, accident or other permissible benefit, constitutes prohibited inurement. Generally, the payment of unreasonable compensation to the trustees or employees of the association, or the purchase of insurance or services for amounts in excess of their fair market value from a company in which one or more of the association's trustees, officers or fiduciaries has an interest, will constitute prohibited inurement. Whether prohibited inurement has occurred is a question to be determined with regard to all of the facts and circumstances, taking into account the guidelines set forth in this section. The guidelines and examples contained in this section are not an exhaustive list of the activities that may constitute prohibited inurement, or the persons to whom the association's earnings could impermissibly inure. See § 1.501(a)-1(c).

(b) *Disproportionate benefits.* For purposes of subsection (a), the payment to any member of disproportionate benefits, where such payment is not

pursuant to objective and nondiscriminatory standards, will not be considered a benefit within the meaning of § 1.501(c)(9)-3 even though the benefit otherwise is one of the type permitted by that section. For example, the payment to highly compensated personnel of benefits that are disproportionate in relation to benefits received by other members of the association will constitute prohibited inurement. Also, the payment to similarly situated employees of benefits that differ in kind or amount will constitute prohibited inurement unless the difference can be justified on the basis of objective and reasonable standards adopted by the association or on the basis of standards adopted pursuant to the terms of a collective bargaining agreement. In general, benefits paid pursuant to standards or subject to conditions that do not provide for disproportionate benefits to officers, shareholders, or highly compensated employees will not be considered disproportionate. See § 1.501(c)(9)-2(a) (2) and (3).

(c) *Rebates.* The rebate of excess insurance premiums, based on the mortality or morbidity experience of the insurer to which the premiums were paid, to the person or persons whose contributions were applied to such premiums, does not constitute prohibited inurement. A voluntary employees' beneficiary association may also make administrative adjustments strictly incidental to the provision of benefits to its members.

(d) *Termination of plan or dissolution of association.* It will not constitute prohibited inurement if, on termination of a plan established by an employer and funded through an association described in section 501(c)(9), any assets remaining in the association, after satisfaction of all liabilities to existing beneficiaries of the plan, are applied to provide, either directly or through the purchase of insurance, life, sick, accident or other benefits within the meaning of § 1.501(c)(9)-3 pursuant to criteria that do not provide for disproportionate benefits to officers, shareholders, or highly compensated employees of the employer. See § 1.501(c)(9)-2(a)(2). Similarly, a distribution to members upon the dissolution of the association will not constitute prohibited inurement if the amount distributed to members are determined pursuant to the terms of a collective bargaining agreement or on the basis of objective and reasonable standards which do not result in either unequal payments to similarly situated members or in disproportionate

payments to officers, shareholders, or highly compensated employees of an employer contributing to or otherwise funding the employees' association. Except as otherwise provided in the first sentence of this paragraph, if the association's corporate charter, articles of association, trust instrument, or other written instrument by which the association was created, as amended from time to time, provides that on dissolution its assets will be distributed to its members' contributing employers, or if in the absence of such provision the law of the state in which the association was created provides for such distribution to the contributing employers, the association is not described in section 501(c)(9).

(e) *Example.* The provisions of this section may be illustrated by the following example:

Example. Employees A, B and C, members of the X voluntary employees' beneficiary association, are unemployed. They receive unemployment benefits from X. Those to A include an amount in addition to those provided to B and C, to provide for A's retraining. B has been found pursuant to objective and reasonable standards not to qualify for the retraining program. C, although eligible for retraining benefits has declined. X's additional payment to A for retraining does not constitute prohibited inurement.

§ 1.501(c)(9)-5 Voluntary employees' beneficiary associations; recordkeeping requirements.

(a) *Records.* In addition to such other records which may be required (for example, by section 512(a)(3) and the regulations thereunder), every organization described in section 501(c)(9) must maintain records indicating the amount contributed by each member and contributing employer, and the amount and type of benefits paid by the organization to or on behalf of each member.

(b) *Cross reference.* For provisions relating to annual information returns with respect to payments, see section 6041 and the regulations thereunder.

§ 1.501(c)(9)-6 Voluntary employees' beneficiary associations; benefits includible in gross income.

(a) *In general.* Cash and noncash benefits realized by a person on account of the activities of an organization described in section 501(c)(9) shall be included in gross income to the extent provided in the Internal Revenue Code of 1954, including, but not limited to, sections 61, 72, 101, 104 and 105 of the Code and regulations thereunder.

(b) *Availability of statutory exclusions from gross income.* The availability of any statutory exclusion from gross income with respect to

contributions to, or the payment of benefits from, an organization described in section 501(c)(9) is determined by the statutory provision conferring the exclusion, and the regulations and rulings thereunder, not by whether an individual is eligible for membership in the organization or by the permissibility of the benefit paid. Thus, for example, if a benefit is paid by an employer-funded organization described in section 501(c)(9) to a member who is not an "employee", a statutory exclusion from gross income that is available only for "employees" would be unavailable in the case of a benefit paid to such individual. Similarly, the fact that, for example, under some circumstances educational benefits constitute "other benefits" does not of itself mean that such benefits are eligible for the exclusion of either section 117 or section 127 of the Code.

§ 1.501(c)(9)-7 Voluntary employees' beneficiary associations; section 3(4) of ERISA.

The term "voluntary employees' beneficiary association" in section 501(c)(9) of the Internal Revenue Code is not necessarily coextensive with the

term "employees' beneficiary association" as used in section 3(4) of the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. 1002(4), and the requirements which an organization must meet to be an "employees' beneficiary association" within the meaning of section 3(4) of ERISA are not necessarily identical to the requirements that an organization must meet in order to be a "voluntary employees' beneficiary association" within the meaning of section 501(c)(9) of the Code.

§ 1.501(c)(9)-8 Voluntary employees' beneficiary associations; effective date.

(a) *General rule.* Except as otherwise provided in this section, the provisions of §§ 1.501(c)(9)-1 through 7 shall apply with respect to taxable years beginning after December 31, 1954.

(b) *Pre-1970 taxable years.* For taxable years beginning before January 1, 1970, section 501(c)(9)(B) (relating to the requirement that 85 percent or more of the association's income consist of amounts collected from members and contributed by employers), as in effect for such years, shall apply.

(c) *Existing associations.* Except as

otherwise provided in paragraph (d), the provisions of §§ 1.501(c)(9)-2(a)(1) and (c)(3) shall apply with respect to taxable years beginning after December 31, 1980.

(d) *Collectively-bargained plans.* In the case of a voluntary employees' beneficiary association which receives contributions from one or more employers pursuant to one or more collective bargaining agreements in effect on December 31, 1980, the provisions of §§ 1.501(c)(9)-1 through 5 shall apply with respect to taxable years beginning after the date on which the agreement terminates (determined without regard to any extension thereof agreed to after December 31, 1980).

(e) Notwithstanding paragraphs (c) and (d) of this section, an organization may choose to be subject to all or a portion of one or more of the provisions of these regulations for any taxable year beginning after December 31, 1954.

(Sec. 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805))

William E. Williams,

Acting Commissioner of Internal Revenue.

Approved: December 30, 1980.

Emil M. Sunley,

Acting Assistant Secretary of the Treasury.

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LETTER FROM LEON IRISH, OF CAPLIN & DRYSDALE, TO IRS ON MASTER AND PROTOTYPE PLAN ADOPTION AND AMENDMENT PROCEDURES, AND IRS RESPONSE

October 10, 1980

Assistant Commissioner of Internal Revenue
Employee Plans and Exempt Organizations
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, D. C. 20530

ATTENTION: William Posner
Special Assistant to the
Assistant Commissioner

Re: Master and Prototype Plan Amendment Procedures

Dear Mr. Posner:

Pursuant to section 4.06 of Rev. Proc. 80-20, 1980-26 I.R.B. 7 (June 30, 1980), we request general information concerning certain procedures for giving notice with respect to the amendment or adoption of corporate master or prototype pension and profit-sharing plans and obtaining determination letters from the Internal Revenue Service (the "Service") with respect to such plans.

Rev. Proc. 79-28, 1979-1 C.B. 569, establishes simplified procedures under which, *inter alia*, sponsors of master or prototype plans may request opinion letters in connection with amendments made to such plans to satisfy final regulations issued under ERISA. ^{*}/ Section 6.01 of Rev. Proc. 79-28 provides that an employer adopting such amendments should not request, and will not receive, a determination letter on such amendments if the sponsoring organization of the plan has received a favorable opinion

letter on the amendments from the Service. Under section 6.02 of Rev. Proc. 79-28, the employer is treated as having received a favorable determination letter with respect to such final regulations amendments so long as the conditions of section 6.01 have been satisfied. One of these conditions, paragraph 3 of section 6.01, is that proper notice must have been given to interested parties. Section 7.01 states, in relevant part, that notices to interested parties must satisfy the general requirements for notice to interested parties as set forth in Rev. Proc. 75-31, 1975-2 C.B. 551, except that, in the case of adopting employers referred to in section 6.01, adoption of the plan amendments shall be treated as an application for a determination letter.

Section 3.02 of Rev. Proc. 75-31 requires that notice to interested parties, if posted or given in person, be given seven to twenty-one days before the application for a determination letter is made. Section 3.03 lists the information that must be contained in the notice, including various deadlines for commenting. Each of these deadlines is a specified number of days after the application for determination is received by the District Director. Since, in the case of master or prototype plans as to which a favorable opinion letter has been issued with respect to final regulations amendments, section 7.01 of Rev. Proc. 79-28 treats the adoption of such amendments by the employer as an application for a determination letter for purposes of the notice to interested parties, the seven to twenty-one day period and all of the deadlines for commenting with respect to such plans are to be measured from the date of employer adoption.

However, Rev. Proc. 80-30, 1980-5 I.R.B. 7 (June 30, 1980), section 16.03, declares Rev. Proc. 75-31 to be superseded. Paragraph 3 of section 15.01 of

^{*}/ The Employee Retirement Income Security Act of 1974, Pub. L. No. 93-406, 88 Stat. 829.

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Approved For Release 2003/11/06 : CIA-RDP84-00688R000200170002-5

Approved For Release 2003/11/06 : CIA-RDP84-00688R000200170002-5